DOW THEORY LETTERS INC.

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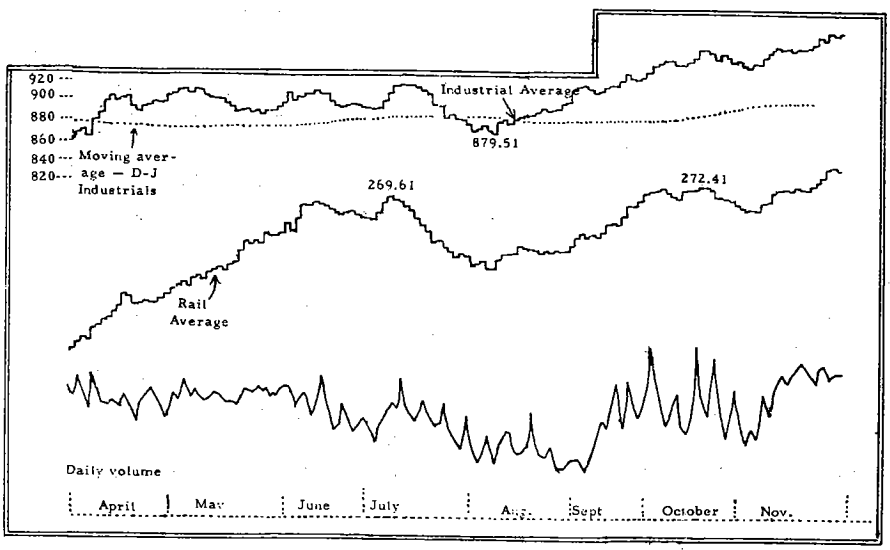
THE MARKET: It seems increasingly obvious to this observer that 1969 is going to be a big crisis year and that the crisis has already started in Europe. For decades the adage held that when "America sneezed, Europe caught cold." Now that adage is about to be reversed, for Europe is moving into the pneumonia stage, and the U.S. will start sneezing shortly.

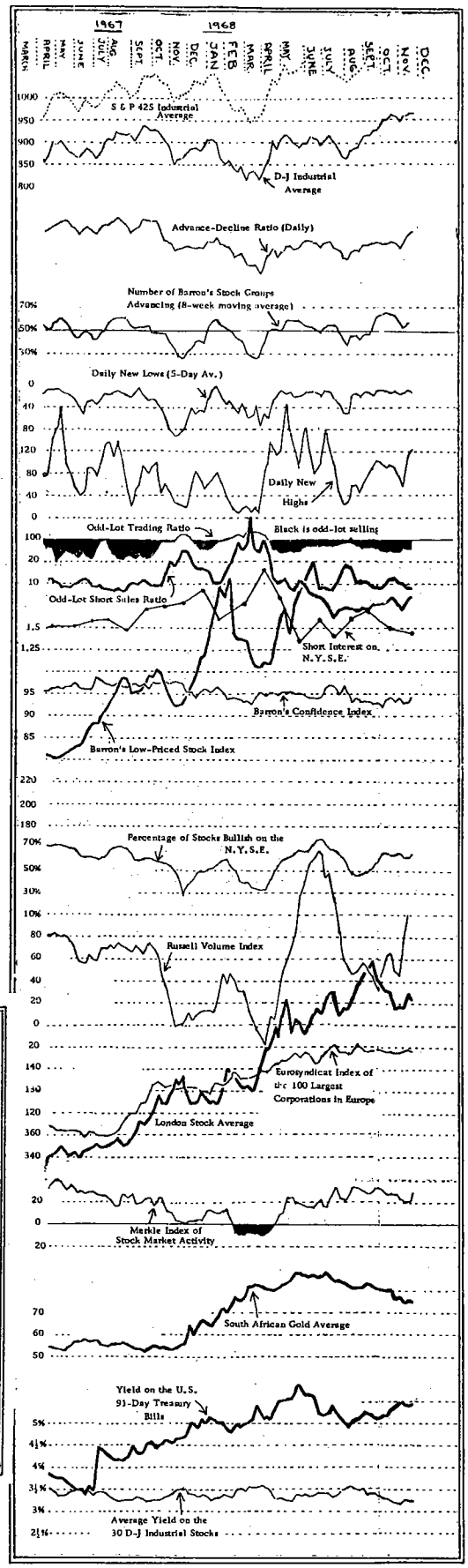
France is going into austerity, Britain is adding new austerity measures to the old ones, but in both countries the economies are sick. Germany is not going to help with a revaluation of the mark, the U. S. is simply stalling for time. DeGaulle's walk-out on a nominal devaluation of say 9% for the franc sets the stage for crisis, and I would guess that the franc may hold another month to four months (see later section). When the franc goes it is going to "go big," as they say, and a minimum devaluation of 25% to 30% should be the expectation. Let the franc devalue by 30% and you can expect to see a series of retaliatory devaluations across the face of the Free World.

Already, devaluation restrictions are cutting trade all over Europe, and this comes at a time when trade needs to be expanded and exports are needed to bolster trade deficits in almost every nation but Germany.

The market discounts, and a few astute observers are now warning their clients of the whirlpool ahead. This morning I was interested in reading E. George Schaefer as he wrote, "I am inclined to believe that as one nation after another puts controls on its imports—that all nations will be doing this in 1969—and the eventual end of it all will be a severe slowing of the economies of the world."

Economist Eliot Janeway writes, "....all over Europe, trade protectionism is being invoked on top of domestic economic deflation. Only after the two preliminary phases of domestic volume deceleration and external trade restrictions will the stage be set for the climactic phase of devaluation. By




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Stock Groups Advancing (8-week moving average)
Daily New Lows (5-Day Av.)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Sales Ratio
Short Interest on N.Y.S.E.
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of Stocks Bullish on the N.Y.S.E.
Russell Volume Index
Eurosyndicat Index of the 100 Largest Corporations in Europe
London Stock Average
Merkle Index of Stock Market Activity
South African Gold Average
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

 the time it comes, Europe will be doing less work. After it comes, Europe will be earning less. For the effect of devaluation is to cut the take-home pay netted by exporting countries."

As I see it then, we are going into a massive monetary mess during 1969, accompanied by a gradual slowing down of the European economies, a spreading of the deflation to the U.S. and an ultimate deflation and probable economic depression.

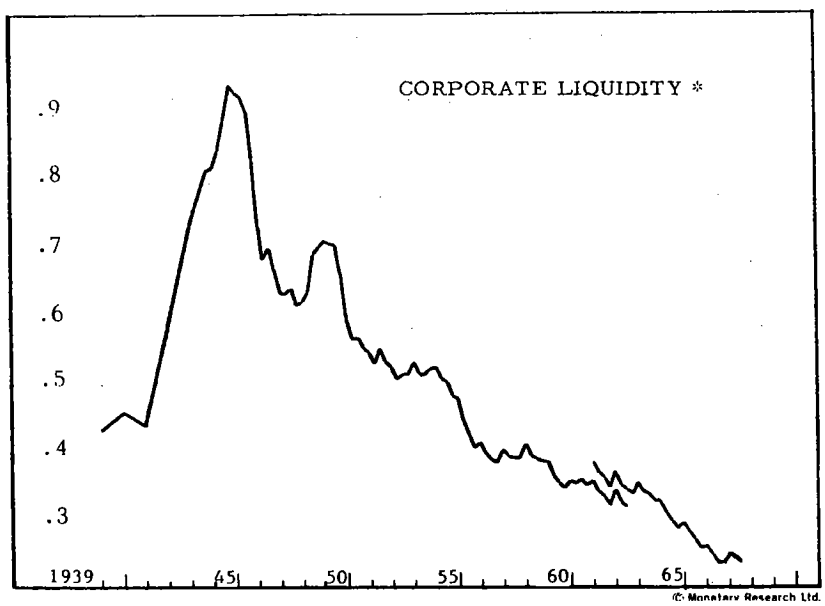
As to the actual timing of such events, that, of course, is the problem. Right now I see the European economies beginning to decelerate. I would place the first shock (probably a franc devaluation) as occurring between now and March. After that, events should move quickly with the stronger European currencies such as the mark being bowled over, interest rates tightening up, and an all-out battle for exports with price cuts being used as ammunition.

Last week as U.S. bond markets moved around their lowest levels since the 1930's (with bonds offering the highest interest rates since the '30's), the U.S. prime rate was raised to 6.5%. This is the bank rate to the prime customers, and it means that the cost of doing business has risen another notch. With corporate liquidity at very low levels, with business borrowing in huge quantities, the squeeze is even moving in on the U.S. scene.

Once the battle for exports goes into full force, I expect interest rates to go sky-high, as nation after nation battles to keep its prices down, its exports up, and its hot money at home. The hot money has already left France and it has moved to the U.S., to Germany and to Switzerland. It will not come back to France at any rate of interest, for big money is interested in safety first, yield second. Watch for a spreading rise in international interest rates from here on. That will be one sign of the beginning of the end.

Meanwhile, back on Wall Street the population is still celebrating the U.S. economic boom of the 1960's. Helped by huge infusions of safety-seeking European hot money, selected stocks have been pushing up amid the usual record-breaking volume of 1968.

On Wednesday (November 27) the D-J Rail Average made history by rising to an all-time high, but as of this writing the Industrial Average has not confirmed. What would it mean if Industrials pushed through their 1966 all-time high of 995.15, thereby confirming the new high in Rails? In this most unorthodox recovery in all stock market history, I would say that new highs on the Industrials would be more of a freak occurrence than anything else. It would come amid severe market strain at a time when the world was teetering on the edge of crisis.



Again, I will draw attention to the fact that the big stocks such as DuPont, General Motors, Chrysler, General Electric, etc., have not led the upward parade, yet these are the stocks which were the backbone of the great advances which occurred during the bull market of 1949-1966. These are the stocks which are most closely tied to the U.S. economy, for there is almost no segment of American industry which does not affect the fortunes of a company like General Motors or DuPont.

In the Bolton Tremblay Bank Credit Analyst which arrived this week the editor notes that corporate liquidity in the U.S. has not fallen to an all-time low (see accompanying Bolton Tremblay chart). This "reflects directly the growing exposure of shock to the corporate sector." Because of the squeeze on cash, corporations are resorting increasingly to non-bank sources for funds. Furthermore, the monetary authorities in the U.S. are literally forced to supply money (regardless of interest rates) or risk a crisis. The Bolton Tremblay organization foresees growing bank credit, still higher interest rates and continuing reduction in corporate liquidity. To me, it is one more danger factor added to the current situation.

Overall, I see the whole financial scene as moving further and further away from the simple "will business be good next year?" type of problem which confronted the stock market during the 1950's and early 1960's. The problems facing the market today are many times more complex and technical than anything seen during the 1949-66 bull

market. Corporate liquidity, gold, money rates, trade deficits, demand deposit velocity, international money rates, trade barriers, these are just a few of the mounting series of difficult situations facing the market today.

The trouble could come initially from any quarter, but as I have attempted to show in previous Letters, when the engine is running at top speed and a wrench is thrown in, it is a far different thing than when a wrench hits an engine which is slowly idling. Any major currency devaluation, any sudden slow-up in business, a European depression, interest rates going through the roof, a major strike in France, any one of these could serve to topple the market structure and set off a series of problems which would spread in domino fashion across the economic scene.

Therefore, I am less and less prone at this late stage of the game to depend on technical gadgets or automatic "signals" from standard technical data. "The market can change its mind in an hour or a day," wrote Robert Rhea. When the bear forces take over in the period ahead, I believe it's going to be a change to be remembered.

FRANCE: The franc has been saved— temporarily. Yet I am of the opinion that the franc will not hold. First, I doubt whether de Gaulle's tough, new deflationary measures are going to prove sufficient to put France in a competitive position with the U. S. and the rest of Europe. But more important (and even more ominous), I do not think that the French are going to stand for the measures de Gaulle has put through.

Even allowing that the majority of Frenchmen want to save the franc (and they undoubtedly do), and even allowing that the majority of Frenchmen are willing to accept austerity (which they probably would), I do not think the French labor unions or the French students are going to go along with de Gaulle's deflationary attempts.

After all, only a few months ago it was the students and the labor unions who went on strike for more university expansion (students) and higher wages (the unions). Now both of these victories will be rolled back, and already there have been harsh words from the unions. One more strike, one more mass protest and the franc will go under again, and this time the devaluation needed will be far larger than the nominal 10% to 15% suggested during October.

Furthermore, it is now clear that West Germany has taken undisputed industrial lead in Europe, and she is not about to give that up. Revaluation (upwards) of the mark is out of the question, so that if trouble strikes the franc again, it will be the franc which will go under. Help from the mark (as had been hoped) can now be written off.

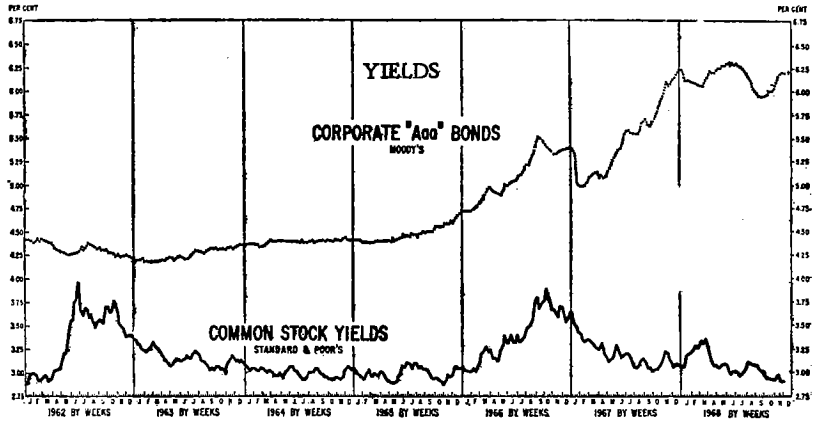
My timing for the devaluation of the franc would be between December and next spring. I do not believe the franc is going to hold out beyond that period. In the event of a franc devaluation, immediate pressure will fall on the pound, the mark, and the Japanese yen. If the franc goes, therefore, I would say that the monetary tower constructed by Bretton Woods will topple within a matter of weeks.

Even if the franc should hold, events of the past twelve months make it clear that a revision of the entire monetary system of the Western World is in order. Therefore, informed observers are of the opinion that one of Mr. Nixon's first acts of 1969 will be the calling of a general monetary conference of the Free World. At that time, drastic changes will have to be brought to the monetary system as the world knows it today. Possibilities at such a meeting will be a rise in the price of gold with adjustments in all the major currencies as to value. Such a sweeping revision, it is held, could carry the monetary system along in terms of another few decades rather than the present month-to-month basis.

From my studies of the statements and opinions of leading economists in the Nixon stable, I would say that these men, taken together, have a fairly clear idea of the needs for a new system and a revision of the price of gold. Furthermore, I continue to note that no Nixon men have taken a public stand on the need to continue the price of gold at its present level. I have been particularly interested in this phenomenon, and I read almost every monetary statement by a Nixon man expressly for signs of a "No" on a gold price boost. So far, nothing has been forthcoming.

STRAIN CONTINUES: The accompanying chart on page 4 (brought up to date this week) is probably the most important single fundamental in the market today. Here we see the yield on the Standard & Poor 500 Stock Average dropping to 2.91%, and thereby holding below the critical 3% level for the 10th straight week in a row. Remember (see last Letter) that in the past decade the average number of weeks the S & P 500 held below

3% prior to trouble was six weeks. Thus, the time element for a correction is bringing about a fundamental strain to the market.

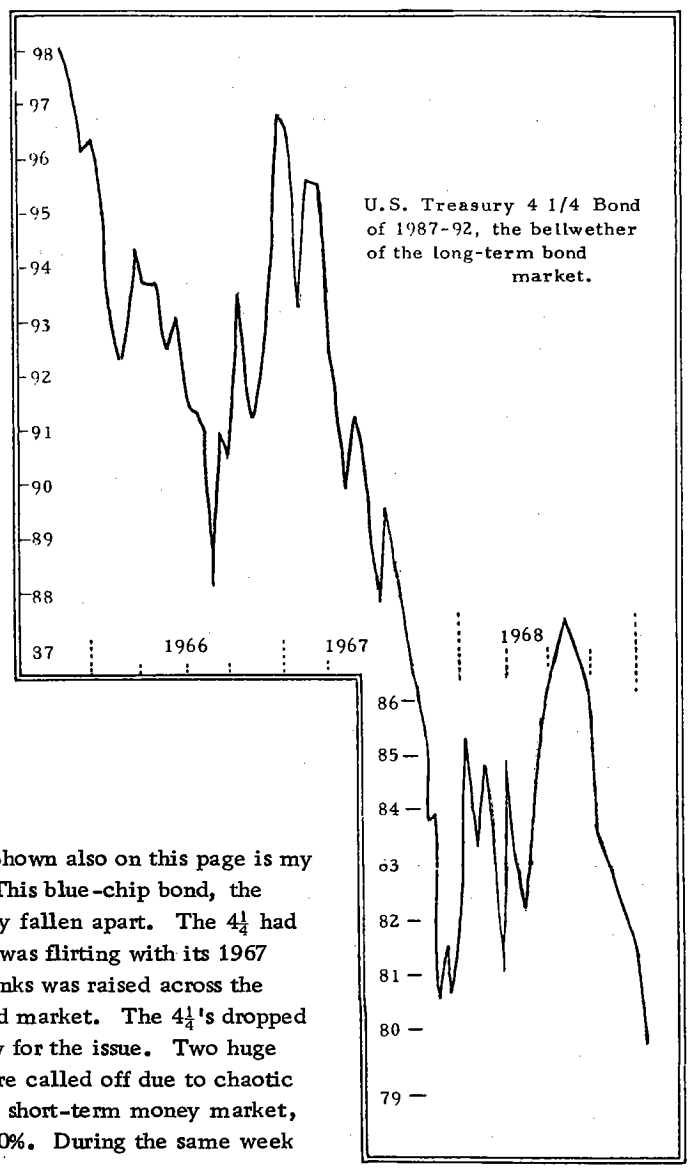


Secondly, the yield on the Moody's Aaa rated bond average rose to 6.16% last week. This is historically a fantastically high yield for top rated bonds. Third, the adverse yield spread between bonds and stocks (in favor of bonds) rose last week to 3.25, just 8 basis points below the all-time record of 3.33 recorded last July 9. Thus the yield study shows that the market is skating on thinner and thinner ice. And every point up in stocks and every tick down in bonds renders the ice thinner.

Speaking of bonds, the authoritative Weekly Bond Buyer (Nov. 25) states that the bond market is set to "make its last stand." Writing further, Editor Charles Brophy explains: "To say that the bond market is going to make its last stand is to say that institutional and individual investors with substantial investment portfolios are giving the bond market one last chance in the current super-cycle of things and that is to say that the capital market sector of the economy is giving the monetary and fiscal authorities one last chance to demonstrate that inflational pressures in the nation can be brought under control in a firm, orderly and meaningful way."

Heightening this statement is the fact that our currency is now more suspect than at any time in the past hundred years. Many individuals and institutions have written off bonds as a repository for money. Many institutions now hold bonds only to conform to the Prudent Man's Rule of not putting all one's eggs in a single basket.

Last week it was announced that the consumer's price index rose at the rate of 7.2% in October, fastest pace in six years. This jolted our ever-optimistic government economists who were hoping that somehow, the 10% surtax would slow things up a bit. Our men in Washington, meanwhile, are pointing out that estimates for October show retail sales slowing down. They state that the October rise in personal income shows a drop in its upward rate. Finally, pre-tax corporate profits for the third quarter were up only $400 million from the second quarter rate, despite an $18 billion jump in GNP. This, they claim, indicates an earnings squeeze which is fated to intensify before it gets better.



All of which has failed, so far, to convince bond buyers. Shown also on this page is my chart of the bellwether U.S. Government $4\frac{1}{4}$ of 1987-92. This blue-chip bond, the trend of which is scrutinized by all bond buyers, has literally fallen apart. The $4\frac{1}{4}$ had slipped into the 81 area by late-October, at which point it was flirting with its 1967 "money crisis" lows. On November 2 the prime rate for banks was raised across the nation to $6\frac{1}{2}$%. This proved to be the last straw for the bond market. The $4\frac{1}{4}$'s dropped 37/32nds on that day to close at 79 15/16 bid, a record low for the issue. Two huge bond offerings (Southern Bell and Natural Gas Pipelines) were called off due to chaotic market conditions. At the same time the bellwether of the short-term money market, the 91-day Treasury bills pushed to 1968 high yields of 5.60%. During the same week

the D-J Municipal Bond Average rose to a record 4.72% yield.

To say that this action in the bond market was significant is to put the case rather mildly. The crunch in the money market is now starting, and I believe that the bond market is one area which has been generally overlooked by the bulls as a potential trouble area. In my opinion, the bond market cannot take much more strain on the downside. Bonds are moving into "panic" territory.

The hopes are that Nixon will "deal" with inflation, that Vietnam will be quickly settled or that the price of gold will be raised, thus taking pressure off the money markets of the world. But remember (as I noted in the opening paragraphs of the last Letter), the market discounts, it looks ahead. If everyone believes that the trouble will wait patiently for the new Nixon administration, everyone could easily be wrong.

As this is written the stock market acts as if it "had seen all this before," so "why not again?" I will again warn subscribers against this complacent attitude. The money crisis, this time, is being accompanied by dangerous monetary conditions across the face of the Free World. Currencies everywhere are at the point of collapse. Each successive money crisis is more difficult to "fix" than the last, particularly when the fundamentals are never dealt with. The fundamentals are inflation, the price of gold and the realignment of leading currencies. None of these are being confronted head-on by the leading nations.

NOTES & QUOTES: At the same time when bonds were sinking to new historic lows, the New York Stock Exchange reported that a seat had changed hands at a record high of $515,000. This is real optimism in the face of monetary peril, and it points up the complacency with which even theN.Y.S.E. is greeting the world money mess.

* * * *

Last week Business Week magazine reported on the explosion in stock market parlor games of all kinds. Their explanation of the phenomenon was rather ominous: "There is, without doubt, a prevailing attitude around the U.S. that treats investments as a game. Not since the 1920's—just before the great crash of 1929—has the public been as much a part of the marketplace nor been willing to risk more on a spin of the wheel of fortune.....since 1962 the number of U.S. shareholders has leaped to nearly 25 million; go-go portfolio managers have stolen the show among mutual funds; and on-again, off-again speculation has characterized the market for nearly three years."

* * * *

According to a special article in last week's Los Angeles Times, France's reserves are much lower than the official figures would suggest. The L.A. Times opines that France's real reserves are down below $3 billion, which, if true, would be a real shocker.

A friend of mine (a former banker) just back from an extended trip to Europe tells me that it is his opinion that Italy will be the next country to run into monetary crisis. As I write this, Italy is facing a severe workers' strike. My banker friend tells me that the general chaos in Europe has stemmed from social disorder which is reflected in monetary disorder.

* * * *

The fact that the gold price held relatively steady during the week of the French crisis is believed by many to have been caused by South Africa selling gold to Central Bankers and on the open market during that period. This seems like the most reasonable explanation to me, and I have seen one estimate which states that S. Africa sold as much as $500 million of gold during the French crisis.

* * * *

According to many sources Britain's Harold Wilson almost panicked on the eve of the franc crisis. West German papers, supposedly quoting from official sources, claimed that Wilson told Germany's ambassador Blankenhorn that unless Germany revalued its mark Britain would reduce its army in the Rhine. Wilson also said, according to the German sources, that a crash would shake the whole Western alliance, and would leave Britain no alternative but to pull in a large number of its guardian troops. Germany, so the report goes, was both adamant and furious at the pressure put upon it by Wilson.

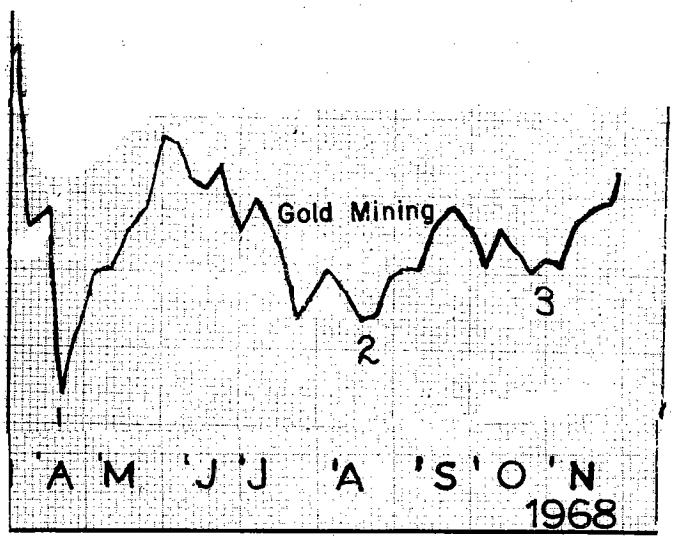
* * * *

When crisis strikes, the weakest currencies suffer first. On December 4 it was announced that during the 10 days of the franc crisis, Britain lost $197 million in reserves. Foreign exchange dealers in London termed this loss a rigged figure and a phoney, claiming the loss was much larger. Nevertheless, the November loss of $197 million

 compares rather ominously with the total loss of $127 million in the three preceding months of August, September and October. Britain's decline in its reserve position marches on.

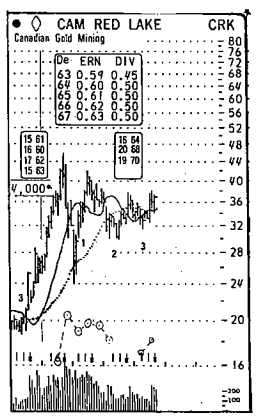
DOW THEORY MARKET LABORATORY PAGE

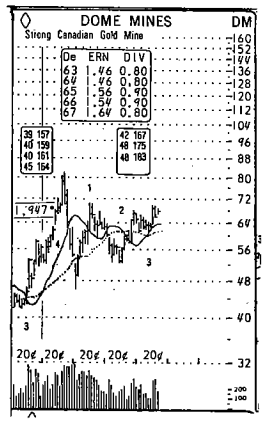
Last week's rally in gold shares brought the N.Y.S.E. gold average above its September peak, to its highest level since last June. The accompanying chart of the gold average (courtesy of Cumulative Average) shows the current position of the gold average, with its series of three ascending bottoms established since April.

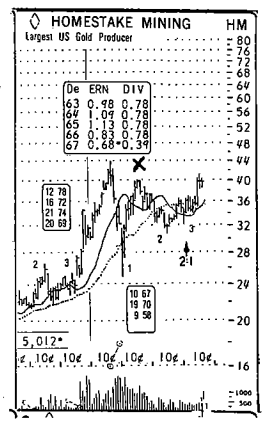


As to the three listed gold mining shares on the N.Y.S.E. and Giant Yellowknife on the Amex, all three show chart patterns in triangles. So sharply etched are these triangles that I have not even bothered to draw in the trendlines. Over the past month, all four of these issues have broken out to the upside with a fair increase in volume.

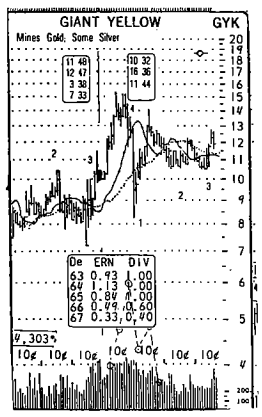
Homestake has been the leader in golds on the N.Y.S.E., and it should be noted that HM is the first issue to better its June peak (marked X on chart). This puts HM in position to try for its all-time high of 43 3/4. At the close on Tuesday (December 3) HM was 2 points below its historic high. My guess would be that if HM moves to a new high, the rest of the gold shares should follow. Secondly, a new high on HM would suggest important monetary trouble brewing, and it should be taken as a warning to all bulls.

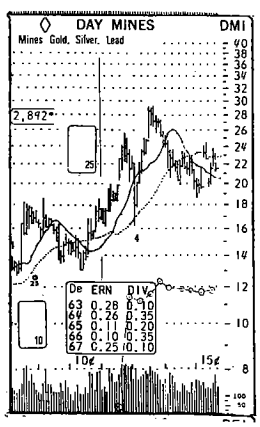


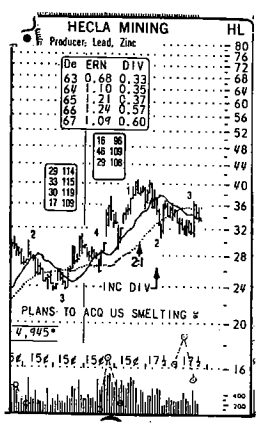




The chart patterns in the silvers is not too different from the golds. There are reports of a currently huge short position in silver on the commodity exchange, and although this is just a rumor it would offer a reasonable explanation for the sluggishness of the price recovery in silver. Obviously, orders to purchase silver can be supplied by others who offer silver on a short-sale basis. The only catch is that sooner or later, the shorts must cover. If the silver rumor is true, then we might expect a real surge in the price of silver during 1969. As a personal opinion, I think such a surge is coming.







The amount of the prime grade .999 silver for sale by the Government is now a topic of raging debate among leading metal experts and market analysts. I cannot get anything approaching the real story from any source, but some of the sources claim (in a most convincing way) that the Government is literally out of .999 silver. Eventually the story will be out, and then we will see who has been truthful and who has not.

The charts for the four gold stocks and the two silvers (Day and Hecla) were supplied courtesy of Quote Digest, 110 North Lorrain, Wichita, Kansas.